

***Interest, Section 10, Designations - Workshop  
Minutes  
October 21 and 22, 1996***

**First discussion item: How to implement of Repeal of OCSLA Section 10.**

**Background:** MMS received 750 OCSLA Section 10 requests in fiscal year 1996 and are currently receiving about 45 per month. MMS verifies (1) that the request is within the 2-year limit, (2) that the recoupment was not previously taken, and (3) that payment has been received on the royalty line being recouped. MMS sends all requests received during the month as a batch for Congressional review.

**Assumption:** For periods prior to RSFA the requirement of Section 10 will apply. For the periods after RSFA, they will need no approval if they take the recoupment within the 6-year adjustment period.

**Discussion:** What is the effective date of the repeal of Section 10 and how will it be applied by MMS?

Does Section 10 apply to over payments made up to August 13, 1996 or to over payments related to production occurring prior to September 1996?

**Action:** After considerable discussion it was decided that MMS would seek advice from the Solicitor's Office and then present their opinion to industry and State representatives.

**Result:** The Solicitor's Office advises that the canons of statutory construction dictate that specific provisions control over the general. Therefore, Section 10 is repealed for payments made after August 13, 1996.

**Discussion:** Several industry representatives felt there should be some relief on the paperwork requirement for the periods before RSFA. Suggestions were: (1) to treat the period before "Repeal" the same as the period after "Repeal" MMS could check Form MMS 2014, Report of Sales and Royalty Remittance (2014) adjustment lines for being within 2 years and having an accepted original line that is being reversed. (2) Raise the de minimis amount to \$25,000 or \$50,000. MMS expressed that they did not know if legally they could alter the Section 10 requirements for periods prior to the effective date of RSFA. These requirements include providing notice to Congress prior to approving the refund recoupment. It was noted that the number of Section 10 requests should drop substantially after the February 1997.

**Action:** MMS agreed to consider the comments and suggestions.

**Second discussion item: Implementation of RSFA interest requirements.**

Discussions were based on a MMS-prepared paper listing interest implementation assumptions.

**Assumption:**Interest will be paid on royalty overpayments made after February 14, 1997.

**Action:**Change the assumption to read, Interest will be paid on Royalty overpayments made *on or* after February 14, 1997.

**Assumption:**Interest on overpayments will be calculated from the due date of the sales month to the last day of the report month that the adjustment is reported.

**Discussion:**The law reads that interest on overpayments accrues from the date the overpayment was made. The question was raised as to whether MMS and industry would be complying with the law if interest reported on the 2014 was calculated from the due date of the sales month. There was general agreement that calculating interest from the due date of the sales month would be simpler than keeping track of thousands of payment dates and would be acceptable as long as it was done the same for both underpayments and overpayments.

**Discussion:**Should the last day of the report month be used as the date to which the interest is calculated to. Currently MMS calculates interest on underpayments to the date the payments are received. However, those who report interest on their 2014 will not always know with certainty when the payment or the 2014 is received by MMS. After much discussion it was concluded that those who report interest on a 2014 should use the due date for the month they report their adjustment as the date to which they calculate interest. For lessee/designee reporting interest on the 2014, MMS will verify that the report and payment are received within 3 days of due date for the month the adjustment was reported. When interest is not reported by the lessee/designee, MMS will calculate interest based on the receipt date of the payment for under payments and the receipt date of the 2014 reporting the adjustment for overpayments.

**Action:**MMS will draft procedures with examples for industry and state representatives to review. The procedures will contain details of the interest formula and calculation method that MMS would use. MMS will proceed with drafting regulations related to paying interest on overpayments and reporting interest on the 2014.

**Assumption:**Interest allowed and paid or credited on overpayments will be reported to the Internal Revenue Service as 1099-I, Interest Income, at the end of each calendar year.

**Discussion:**Interest allowed and paid or credited to lessee/designee will be reported in accordance with IRS instructions on a calendar year basis. Industry representatives pointed out that Corporations are exempt from the 1099 requirement.

**Action:**MMS will research the IRS interest reporting requirements and draft procedures for meeting this requirement.

**Assumption:**Interest attributed to any amounts previously disbursed to a State, the Reclamation Fund, or any other recipient designated by law shall be deducted from the next disbursements to that recipient made under the applicable law.

**Discussion:**There was no discussion or action related to this assumption.

**Assumption:**Interest will be reported on the same Form MMS 2014, Report of Sales and Royalty Remittance, that the adjustment is reported.

**Discussion:**Interest could be reported on a separate 2014, but the lessee/designee must follow MMS requirements to ensure the royalty 2014 containing the adjustments and the interest 2014 would be combined by MMS similar to the combination of tape and paper 2014 documents today.

**Action:**MMS will draft procedures for combining royalty documents for purposes of verifying interest paid and payable when companies report interest and when adjustments are on one 2014 and interest is on another.

**Assumption:**Interest will be calculated and reported by lease and sales month/year. When making an adjustment, lessees must follow the instructions in the Oil and Gas Payor Handbook Section 4.2 "Reporting Principles for Adjustments," the incorrect line as it was most recently reported is reversed and the new correcting line is reported. A third line, following these entries, will report interest from the due date of the sales month/year to the date of payment.

**Discussion:**For MMS to distribute interest to the States and others, the Lease Number must be included. To calculate interest, the sales month/year must be included.

**Conclusion:**Interest will be calculated and reported by lease and sales month/year.

**Assumption:**Four new transaction codes will be used when reporting interest on a 2014.

Interest on underpayments.

Interest on overpayments.

Insufficient estimate interest.

Interest on over estimates.

**Discussion:**Make reporting as simple as possible with a minimum number of new codes. Will need to separate interest received from interest paid on the Explanation of Payments sent to States and other agencies.

**Action:**MMS will consider using only two Transaction Codes.

**Assumption:**Interest will be compounded daily at the rates specified by section 6621 of the Internal Revenue Code of 1986 subparagraphs (a) (1) for overpayments and subparagraphs (a) (2) for underpayments.

**Discussion:**No discussion or action on this assumption.

**Assumption:**Interest reported on Form MMS 2014 will be periodically validated by MMS. If interest is not reported on Form MMS 2014, MMS will calculate and bill interest on underpayments and calculate and credit interest on overpayments.

**Discussion:**No discussion or action on this assumption.

**Assumption:**The lessee will have determined that the interest reporting requirements are a "Hardship" unless they report interest on their 2014.

**Discussion:**MMS does not need justification from the lessee/designee as to why they are a "Hardship." Some said it would not look appropriate if large companies claimed "Hardship." After discussion there was general agreement that unless interest was reported on a 2014 the lessee/designee reporting the adjustment lines was claiming a "Hardship", and thus MMS would calculate the interest. This process would be repeated for every adjustment made on every lease for every month automatically.

**Assumption:**If MMS determines that overpayments for any given report month exceed 10 percent of the lessees' total payments for all leases, interest will not be paid on the excessive amount of such overpayment.

**Discussion:**Because of the requirement that excessive overpayments have to be made for the sole purpose of receiving interest, MMS will not be programming their computer system to check for excessive overpayments. Instead they would only review the largest interest payment/credits, and perhaps review for this issue during audits.

**Assumption:**Interest on over and under estimates will be calculated consistent with RSFA.

**Discussion:**There was a short discussion on whether estimates would still be used by industry. Industry representatives indicated they planned and needed estimates, and planned to use them in the future. The primary reason for needing estimates was that sufficient information was not available by the normal payment due date to prepare the 2014.

It was discussed that the estimate would only extend the reporting date for first time reporting. Interest on subsequent adjustments both overpayments and underpayments would be calculated for the sales month due date.

**Assumption:**Issues as they arise such as content of the BILL/CREDIT document would need to be acceptable to MMS, industry and States.

**Action:**MMS will provide detail information on how they would calculate interest. States and industry would have an opportunity to comment on all MMS assumptions.

**Conclusion:**Everyone agreed that fast progress is needed to get the interest systems in place, and information furnished to industry and States.

**Third discussion item: How to implement the requirements to make demands or orders to pay when the payors are designees.**

**Background:**MMS currently sends between five hundred and one thousand bills to royalty payors during a month. The RSFA will require that if demands are sent to payors who act as designees for lessees (either owners of record title or operating rights) that notices go to the lessees.

**Assumption:**RSFA requires notification to lessees when orders to pay are issued to

designees. Also MMS must be able to tell lessees how much each of them owes. MMS must have some database(s) which track(s) the relationship of lessee to designee as well as the identity of all owners of operating rights. As of the date of the meeting no one had designated another person to pay on their behalf.

The average number of record title owners per lease is approximately four; there are perhaps a similar number of owners of operating rights owners per lease is approximately four. MMS sends out between five hundred and one thousand bills per month, which implies that there will be almost 50,000 notices to lessees per year.

**Discussion:**The term "payor" may no longer be appropriate. RMP does not know who the operating rights owners are, but BLM and OMM have records. Under the old law, MMS at the third step bill follow-up goes to the lessee of record for payment. Under RSFA, MMS must send a notice to the lessees when an order to pay is sent. According to Section 102(a), units or communitization agreements which contain only Federal leases with the same royalty rate and funds distribution report on takes, and there are two parties that each own 50% operating rights, and one of them takes 100% and doesn't pay, both operating right owners are liable for their 50%.

**Issue:**How can MMS receive written designations?

**Discussion:**RMOGA told its members not to send in designations because MMS can't handle them. Some MMS managers echoed that message.

**Action:**MMS believes it needs to develop a process for receiving designations so that it may send out the notices required by RSFA to make bills demands.

**Issue:**What is the effect if a person pays without being the lessee and without written designations?

**Discussion:**MMS will, for the near term, conduct business as usual. However, eventually MMS will need the designations to issue demands.

**Issue:**How can MMS issue a demand if it does not know ownership of a lease (however it is divided)?

**Discussion:**MMS has subpoena power, and can issue an order to whom it is supposed to be issued and then subpoena. Is MMS protected without an operating rights owner data base?

**Issue:**How can MMS trace lease ownership years after production occurs?

**Discussion:**MMS can use the lessee data base, BLM has good records on record title and weaker records on operating rights owners. What happens if a lessee does not file with the BLM or OMM when operating rights are transferred? -Does DOI need an automated data base of operating rights, if not what is the alternative?

**Issue:**How can MMS receive the written designations?

**Discussion:**Jimmy Mayberry (MMS), and Ben Dillon (IPAA) had talked with some

onshore New Mexico working interest owners (individuals) that own less than 1% to 3%, and they are concerned about filing written designations.

Does MMS need two data bases, one for operating rights owners and one for designees? Does MMS need formal data bases or is there an alternative? To assure that all lessees file, what happens if they don't file?

What are the consequences of payments received from parties that are not lessees or lessee hasn't designated them as a designee? The money is received and deposited by MMS, the report lines clear, and exception processing bills are created for the paying and reporting party.

What happens if a paying and reporting party is not a lessee or designee and there is an underpayment? MMS sends a bill (not a demand) to the paying and reporting party (if the paying and reporting party is a lessee or designee then a demand is sent).

According to RSFA the designation of operating rights is effective on the date received by the Secretary. This is not industry practice and it will have to be retroactive to the date of the actual transfer, not when it is received by the Secretary. The operating rights transfer occurs in a contractual agreement with signatures, and it is impossible to have it filed with the Secretary on the same day that the signatures are obtained. It would be logical for MMS to allow retroactive designations.

The simplest way to do this is to have the current payors get the designations. The form would originate with the designee, and the designee gets the lessee signatures.

Five or six years after payments are made and MMS needs to know who the lessees were for a certain period of time, have the designees supply the lessee information.

The percent of operating rights ownership is not feasible for MMS' automated data base. It is too expensive for industry to get this information, and it would have no integrity according to industry representatives.

There are two categories of payors, lessees and designees. The designees have the lessee data (they know whom they are paying for), why can't they tell MMS who these are without an ownership percent level?

Exception processing bills are sent to designees. If ignored, at what point does MMS look behind the designee? Exception processing bills are currently orders to pay and are valid receivables. Following RSFA, MMS has to send the demand to the designee with a notice to the lessee when the infraction occurs, so that the lessee knows of the obligation before interest starts accruing. If the order remains unpaid, at the third step follow-up the operating rights ownership (percentage) would have to be determined in order to send out demands for each pro rata share of the liability.

What if it is not an order to pay, but a courtesy notice or audit issue letter, does a person have a duty to pay, or is it an unenforceable piece of paper? A courtesy notice or audit issue letter is not a receivable or "booked." MMS tries to resolve the issue as we don't want it to become an order to pay. However, if it cannot be resolved, then MMS would

issue an order to pay.

Courtesy notices, audit issue letters, and if it is determined that interest bills are not orders to pay and are not receivables or in the system, then industry cannot use interest credit (overpayments) to offset, if MMS is calculating the interest. Bills must be updated in the system in order for a payor to receive the benefit of offsetting overpayment interest with underpayment interest owed

If MMS has a lessee data base, then orders to pay can be sent out. However, if MMS doesn't have operating rights percentage ownership then they cannot calculate each pro rata share of the liability.

The BLM has good records on lessee of record, but they don't know how complete their records are for operating rights owners. After 1988 BLM no longer adjudicated operating rights, but does approve them for bonding and record purposes, and these are in the lease files. Now that MMS is only going to require the percentage of operating rights ownership on an exception basis, is it feasible for BLM to build an automated data base? They would have no problem responding to MMS's requests for operating rights ownership, depending on the number of requests at any given time.

MMS should send out the notices to all lessees for the full amount of the order to pay. If the designee or the lessee doesn't pay, then at the third step follow-up (liability) phase, the percentage of operating rights ownership can be researched (BLM or OMM), and then each lessee's order to pay would reflect the pro rata share of the liability.

**Conclusion:**For MMS to issue an order to pay to a payor who is paying as a designee, a notice to the lessees who have designated that designee must accompany that order. MMS does not need to send a copy of the bill, nor does MMS need to determine (at the time of billing) the amount of royalty owed by each lessee to issue demands. MMS may issue notices of some sort to designees, without notifying lessees, prior to issuing demands.

**Action:**To accomplish the immediate goal, it was decided to send out a "Dear Payor" letter for current active producing leases within one to two weeks with an attached list of leases that payor pays on.

The payors would then respond and inform MMS

- For which of these leases they are a lessee (operating rights owners or lessee of record) and for which they are designated to pay by the lessees.
- If they are a designee, they will provide MMS with name and address of the lessee(s) they are designated to pay for (% of ownership not required).

The "Dear Payor" letter will request that the attached list of leases be returned. If someone wishes to electronically submit this data, they may contact MMS for assistance.

After MMS receives this information, then MMS will write to the lessees

requesting written designations. For the month of November 1996, MMS will issue interim courtesy notices to designees, and orders to pay to lessees.

**Conclusion:** The "Dear Payor" letter is good for the initial data base, but what about modifications and changes and the updating of the data base?

#### *Issues To Be Discussed At Next Meeting*

The following open issues will be discussed at a follow-up meeting on November 18, 1996, in Denver (the day preceding the next full working group/MMS meeting in Denver).

How to implement the requirements to make demands or orders to pay when the payors are designees.

#### Written Designations:

- Can written designations be submitted electronically?
- Should the PIF be used for the written designations?
- Should the information from the designee or lessee include the revenue source, type of payment (rent, minimum royalty, or royalty) and product code?
- What should be the format for the designation form?
- Should there be one form, or two different forms; one for the designee (telling us who the lessees are), and one for the lessee (telling us who the designee is)? If there are two different forms, the information can be cross-checked to determine if it matches.
- Does the designee need an acknowledgment that they are the designee?

When an order to pay is issued to the designee, should the notice to the lessee be a copy of the order to pay, or a notice telling the lessee that the designee has been issued an order to pay giving the total amount, and the payment due date?